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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 000580

SIPDIS

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SUBJECT: EUR DAS BRYZA'S MEETING WITH ARMENIAN PRIME  
MINISTER

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Classified By: Ambassador Marie L. Yovanovitch. Reasons 1.4 (b/d).

SUMMARY

1. (C) Prime Minister Tigran Sargsian provided EUR DAS Matthew Bryza an overview of Armenia's current economic difficulties, and noted the severe blow represented by the continued hold placed on Millennium Challenge Corporation (MCC) roads funding. Bryza reminded that the MCC program is performance-based, and that the USG hopes to see continued progress on democracy and human rights, particularly with regard to amnesty for political detainees. He hopes that such progress could lead to renewed USG support, and indicated the USG would continue financial and technical assistance in key areas targeted for reform. Bryza assured that the USG would continue to support credits to Armenia from international financial institutions to help the country weather the crisis. Sargsian showed interest in a proposed USG initiative reach out to diaspora communities to support projects in various countries, agreeing it could be used to support a priority road project from the Georgian border to Yerevan. END SUMMARY.

LARGEST GDP DECLINE IN THE CIS

2. (C) EUR DAS Matthew Bryza's August 7 meeting with Armenian Prime Minister Tigran Sargsian focused on the impact of the global economic crisis on Armenia. Armenia's GDP declined by 16.3 percent in the first half of 2008, the largest drop in the CIS. This year the GOAM projects a budget deficit of about USD 700 million, equal to 7.5 percent of GDP. Most of this shortfall will be made up by loans from the IMF, World Bank, ADB and Russia. The GOAM expects as large a deficit in 2010 and at best one percent growth in GDP, which will create serious social problems in the country.

LOSS OF MCC FUNDING A BLOW

3. (C) Sargsian lamented that the June decision to continue the hold on MCC road funds was a serious blow to the GOAM, particularly in light of the global financial crisis and its impact on the government's budget, which earlier this year was cut about 10 percent due to severe revenue shortfalls. While last year the GOAM made up for about USD 16 million in withheld MCC funds to continue road projects, it is not able to do so this year. The still-uncompleted projects will be transferred from MCA-Armenia to the Ministry of Transport, which will need to find funding for their completion. (Comment: We understand the GOAM is seeking funds from the World Bank and ADB for these projects. End Comment).

4. (C) Bryza indicated that the USG is well aware of the impact of the financial crisis on Armenia, and understands

the loss from the continued hold on MCC roads funding. He reminded Sargsian, however, that MCC was designed not simply as an aid program but as a means to promote democracy and good governance. He noted that despite the hold, the USG has maintained two-thirds of the program's funding (for irrigation canals and other non-road projects) and hopes that with recent encouraging developments like the detainee amnesty, there might be a way for the USG to eventually provide assistance for remaining road projects, though outside the auspices of MCC. With regard to budget support, Bryza noted that the U.S. is the largest stakeholder in all three institutions, and has consistently supported increased budget support to Armenia to help the country weather the current financial crisis.

#### CUSTOMS AND TAX REFORM KEY TO DEMOCRATIZATION

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15. (C) The PM asserted that reforms of the customs and tax Services -- perennially among the most corrupt and dysfunctional parts of the GOAM -- are the cornerstone of all democracy reforms. Armenia cannot be truly free and democratic without free elections and fair tax administration. The GOAM has sought USG technical and financial assistance to pursue reforms in these areas (Note: USAID will soon have a tax reform program in operation, replacing one that was terminated in mid-2008. End Note). Bryza agreed that democracy and fundamental issues like tax reform go together, and praised Sargsian for focusing on these areas.

#### ENGAGING THE DIASPORA

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16. (C) Bryza advised Sargsian of the Secretary's nascent

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initiative to engage diaspora communities around the world in support of projects in their ancestral countries. Sargsian noted that the GOAM has a project with the German agency KfW that might serve as a useful model. Bryza suggested that a continuation of the MCC-funded road in Georgia connecting Javakh and Tbilisi that extends to the Armenian border and eventually to Yerevan is a potential project to be funded through such an entity. The Prime Minister, who is seeking funding for such a project, was extremely interested.

#### COMMENT

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17. (C) The Prime Minister faces serious challenges in addressing Armenia's troubled economy, and with the crisis caused largely by external factors, he has few tools at his disposal. Sargsian understands the reason for the loss of MCC funding, but is not in a position to enact the changes that could have restored it. We are hopeful that Sargsian is serious in his stated intention to pursue reform in the tax and customs services, but with the entrenched interests he will face, it may be a challenge too great for even his best intentions. END COMMENT.

18. EUR DAS Bryza has not cleared this cable.  
YOVANOVITCH